89-1989

No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

TENNESSEE SMALL GENERAL SERVICE CUSTOMER GROUP, *et al.*,
Petitioners,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MICHAEL J. MANNING
Counsel of Record
JAMES F. MORIARTY
FULBRIGHT & JAWORSKI
1150 Connecticut Ave., N.W.
Suite 400
Washington, D.C. 20036
(202) 452-6800
Attorneys for
Tennessee Small General Service Customer Group

JAMES R. CHOUKAS-BRADLEY
DEMETRIOS G. PULAS, JR.
MILLER, BALIS & O'NEIL, P.C.
1101 14th Street, N.W.
Suite 1400
Washington, D.C. 20005
Attorneys for
Cities of Clarksville, Springfield, and Portland, Tennessee, and Humphreys County Utility District, Tennessee

DAVID B. WARD
FLOOD & WARD
1000 Potomac Street, N.W.
Suite 402
Washington, D.C. 20007
Attorneys for
Western Kentucky Gas Company, A Division of Atmos Energy Corp.

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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QUESTIONS PRESENTED

A. Whether the court of appeals exceeded its reviewing authority or otherwise erred in interpreting the judicially-created filed rate doctrine as preempting the just and reasonable rate standard of the Natural Gas Act.

B. Whether the court of appeals erred in not harmonizing, as did the Commission, the filed rate doctrine with the statutory requirement for just and reasonable rates.

C. Whether the court of appeals erroneously applied the filed rate doctrine by confusing retroactive ratemaking with current ratemaking utilizing allocation factors based upon past actions.

PARTIES TO THE PROCEEDING BELOW

A list of the parties to the proceeding below is contained in Appendix J to the Joint Appendix (hereinafter referred to as "J.A."). Petitioners' Rule 29.1 statement is attached hereto.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Tennessee Small General Service Customer Group, The Cities of Clarksville, Portland, and Springfield, Tennessee and the Humphreys County Utility District, Tennessee, and Western Kentucky Gas Company, a Division of Atmos Energy Corp. (collectively referred to hereinafter as the "Small Customer Group") hereby petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit issued in this case.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 893 F.2d 349 (D.C. Cir. 1989). It is reproduced as Appendix A to the J.A. The opinion on denial of rehearing and suggestions for rehearing *en banc* of the Court of Appeals is reported at 898 F.2d 809 (D.C. Cir. 1990). It is reproduced as Appendix B to the J.A. The order of the Court of Appeals staying its mandate for sixty days

pending petitions for writ of certiorari is reproduced as Appendix C to the J.A.

The opinion of the presiding administrative law judge of the Federal Energy Regulatory Commission, reported at 40 FERC ¶ 63,008 (1987), is reproduced as Appendix D to the J.A. The initial opinion of the Federal Energy Regulatory Commission, reported at 42 FERC ¶ 61,175 (1988), is reproduced as Appendix E to the J.A. The opinion of the Federal Energy Regulatory Commission on rehearing, reported at 43 FERC ¶ 61,329 (1988), is reproduced as Appendix F to the J.A.

GROUNDS FOR THIS COURT'S JURISDICTION

The judgment of the Court of Appeals was entered on December 28, 1989. On March 30, 1990, the Court of Appeals denied rehearing and suggestions for rehearing *en banc*. On April 23, 1990, the Court of Appeals stayed its mandate in tnis matter pending the filing of petitions for a writ of certiorari. The jurisdiction of this Court is invoked under Section 1254(1) of Title 28 of the United States Code.

STATUTES INVOLVED

Section 4 of the Natural Gas Act, 15 U.S.C. § 717c(a) and (d), provides:

> All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.
>
> Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except

> after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect.

Section 5 of the Natural Gas Act, 15 U.S.C. § 717d(a), provides:

> Whenever the Commission . . . shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order[.]

Section 19 of the Natural Gas Act, 15 U.S.C. § 717r (b), provides:

> Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain review of such order in the court of appeals . . . The finding of the Commission as to the facts if supported by substantial evidence shall be conclusive.

FEDERAL JURISDICTION

This cause of action arose under Section 717c(a), 717c (d), 717d(a) and 717r(b) of Title 15 of the United States Code.

STATEMENT OF THE CASE

This case represents the seminal administrative proceeding in which the Federal Energy Regulatory Commission ("Commission") established just and reasonable

rates, and fair and equitable procedures, for resolving the $1.5 billion take-or-pay liabilities of an interstate natural gas pipeline. In so doing, the Commission, following an exhaustive review of the record and lengthy deliberations, applied to Tennessee Gas Pipeline Company ("Tennessee") the agency's long evolving Order No. 500 policy statement. Order No. 500 permits a pipeline to share 50-50 with its customers the costs paid to producers to "reform" or "buydown" future contractual obligations, as well as to "buyout" existing liabilities.[1] To date, as part of its efforts under the Natural Gas Policy Act to create a competitive marketplace for the purchase and transportation of natural gas,[2] the Commission has continued to rely on Order No. 500 in approving the 50-50 sharing of up to $8 billion in such costs on most of the interstate gas pipelines in the United States.[3]

The decision of the Court of Appeals, contrary to the precedent of this Court, cripples the policy formulated by the Commission to effectively address the take-or-pay crisis. In addition, the Court of Appeals eviserates the

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[1] *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 500, FERC Stats. & Regs. ¶ 30,761, *reh'g*, Order No. 500-B, FERC Stats. & Regs. ¶ 30,772, *reh'g*, Order No. 500-C, FERC Stats. & Regs. ¶ 30,786 (1987), *American Gas Ass'n, et al. v. FERC*, remanded 888 F.2d 136 (D.C. Cir. 1989). Order No. 500 followed Order No. 436 which the D.C. Circuit vacated while upholding the substance of the Commission's policies. *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 436, FERC Stats. & Regs. ¶ 30,665, *modified*, Order No. 436-A, FERC Stats. & Regs. ¶ 30,675 (1985), *modified*, Order No. 436-B, FERC Stats. & Regs. ¶ 30,688, *reh'g denied*, Order No. 436-C, 34 FERC ¶ 61,404 (1986), *reh'g denied*, Order No. 436-D, 34 FERC ¶ 61,405 (1986), *reconsideration denied*, Order No. 436-E, 34 FERC ¶ 61,403 (1986), *vacated and remanded sub nom. Associated Gas Distribs. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988).

[2] 15 U.S.C. § 3301 *et seq.*

[3] Order No. 500-H, FERC Stats. and Regs. (CCH) [Reg. Preamble] ¶ 30,867 at 31,523 (1989).

"just and reasonable" rate standard of the Natural Gas Act and frustrates completely the Commission's efforts to administer its organic statute. Rather than deferring to the expertise of the federal agency entrusted by Congress to regulate the natural gas industry, the Court of Appeals substituted its judgment for that of the Commission as to what are "just and reasonable" rates on the Tennessee system.

As to the facts of this case, Tennessee filed tariff sheets containing the rates, terms, and conditions of service it proposed for operating as an open-access transporter pursuant to Order Nos. 436 and 500. Tennessee also proposed to directly bill its customers up to 80 percent of non-affiliate past and future take-or-pay payments. Under its proposal, Tennessee agreed to absorb only 20 percent of non-affiliate and all affiliate take-or-pay costs.

On July 2, 1986, the Commission firmly rejected Tennessee's take-or-pay proposal and set the matter for hearing.[4] After four weeks of hearings, the presiding administrative law judge concluded that Tennessee's gas purchasing and contracting practices were prudent and reasonable.[5] In addressing the take-or-pay cost recovery issues, the judge ruled that: (i) Tennessee could directly bill all of its customers a proportionate share of fifty percent of non-affiliate take-or-pay costs; and (ii) the company had to absorb the remaining 50 percent.[6]

Following the judge's decision, and while exceptions were pending before the Commission, the parties initiated settlement negotiations. On October 14, 1987, Tennessee filed a settlement proposal with the Commission

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[4] *Tennessee Gas Pipeline Co.*, 36 FERC ¶ 61,032 (1986).

[5] *Tennessee Gas Pipeline Co.*, 40 FERC ¶ 63,008 at 65,008 (1987), (J.A. at 70a).

[6] *Id.* at 65,012 (J.A. at 80a).

that did not employ the Order No. 500 purchase deficiency allocation methodology. Various customers eventually offered five separate, independent settlement proposals.[7] On November 3, 1987, the Small Customer Group filed its settlement proposal basing take-or-pay liability allocation *solely* on cumulative purchase deficiencies in accord with the guidelines of Order No. 500.

On February 8, 1988, the Commission approved Tennessee's settlement proposal with modifications.[8] Under its terms, Tennessee agreed to absorb 50 percent of non-affiliated take-or-pay costs and to directly bill the remaining 50 percent, up to $650 million, to customers through a fixed direct billed surcharge.[9] Each customer's surcharge for take-or-pay was to be based in part on past purchase deficiencies. However, contrary to Order No. 500, each customer's so-called "contract reformation" costs would be measured on annual contract entitlements.

On requests for rehearing filed by certain parties, including the Small Customer Group, the Commission reversed itself and properly applied the Order No. 500 policy statement, ordering Tennessee to allocate all of its current take-or-pay costs on the basis of the purchase deficiency methodology. In weighing the multitude of competing interests and considerations presented, and

[7] The five competing settlement proposals were submitted by: (1) the Small Customer Group; (2) Consolidated Edison Company of New York, Inc., The Brooklyn Union Gas Company, Long Island Lighting Company, and Public Service Electric and Gas Company; (3) the New England Customer Group; (4) Consolidated Gas Transmission Corporation, and (5) National Fuel Gas Supply Corporation. Each proposal contained a different methodology by which take-or-pay costs could be allocated to Tennessee's customers. Comments were filed on all of the proposals showing a great divergence of views.

[8] *Tennessee Gas Pipeline Company*, 42 FERC ¶ 61,175 (1988) (J.A. at 94a).

[9] *Id.* at 61,630 (J.A. at 97a).

with genuine concern for the health of the industry and for Tennessee in particular, the Commission made two basic findings:

1. The purchase deficiency allocation methodology is the only way to "produce just and reasonable results"; and

2. "[C]ompliance with cost incurrence principles based on past purchase deficiencies, as established in Order No. 500, is required to ensure the reasonable allocation of costs on Tennessee's system. . . . [A]llocating these costs on the basis of past purchase deficiencies links more closely current cost incurrence with cost causation."

Tennessee Gas Pipeline Company, 43 FERC ¶ 61,329 at 61,929 and 61,930 (1988) (J.A. at 148a and 150a-151a). These findings satisfied the demands of the Natural Gas Act that rates be "just and reasonable".

The Court of Appeals, without determining whether the rates charged were "just and reasonable", summarily reversed the Commission and held that the agency's decision violated the filed rate doctrine as announced by this Court in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981). Effectively, the Court of Appeals interpreted the judicially-created filed rate doctrine as supplanting, rather than complementing, the just and reasonable rate standard of the Natural Gas Act.

Three Circuit Judges strongly dissented from the denial by the Court of Appeals of suggestions for rehearing *en banc.* Finding, contrary to the panel, that the Commission's decision "did not violate the filed rate doctrine," but rather represented "a good faith, and not unreasonable" approach, the Circuit Judges explained that "[i]n a time when the structure of the natural gas industry is undergoing a sea change, the FERC must be granted considerable discretion to ensure that the tran-

sition period is handled in a manner that minimizes the disruption in the industry." 898 F.2d at 811 (J.A. at 33a-34a). The three Circuit Judges explained that, if left undisturbed, the panel's decision will leave the Commission, entrusted by Congress to regulate the natural gas industry, "essentially powerless to take care of the take-or-pay crisis." *Id.* (J.A. at 34a).[10]

REASONS FOR GRANTING THE PETITION

I. The Improper Expansion Of The Filed Rate Doctrine Conflicts With Decisions Of This Court And Eviscerates The Just And Reasonable Rate Standard Of The Natural Gas Act

Our discussion of the filed rate doctrine begins, as it should, with this Court's opinion in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981) ("*Hall*"). Simply stated, the doctrine "prohibits a federally regulated seller of natural gas [such as Tennessee] from charging rates higher than those filed with the Federal Energy Regulatory Commission[.]" *Id.* at 573. In *Hall*, the Court found that "a rate [resulting from a state damage award] never filed with the Commission and thus never found to be reasonable within the meaning of the Act", *id.* at 579, "amounts to nothing less than the award of a retroactive rate increase based on speculation about what the Commission might have done had it been faced with the facts of this case." *Id.* According to the Court, this "is precisely what the filed rate doctrine forbids," *id.* at 579, since the "*clear purpose of the congressional scheme* [*is to grant*] *the Commission an opportunity in*

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[10] Indeed, on May 31, 1990, Chief Judge Wald, in a separate statement filed on the rehearing *en banc* request in *Transwestern Pipeline Co. v. FERC*, 897 F.2d 570 (D.C. Cir. 1990), reiterated her concern: "It remains for the Supreme Court to settle this important question of how impenetrable a barrier the filed rate doctrine is to FERC's efforts at allocating the inevitable burdens stemming from fundamental readjustment of the pipeline industry." (J.A. at 193a).

every case to judge the reasonableness of the rate." *Id.* at 582 (emphasis added). Unlike in *Hall*, the Commission here fully exercised that opportunity and found the subject rates just and reasonable.

As Justices Stevens and Rehnquist explained in their dissent in *Hall*, addressing yet another "extension of the so-called 'filed rate doctrine'," the procedural niceties of the doctrine are designed only to protect "the substantive policy underlying the statutory requirement that all rates be just and reasonable." *Id.* at 593. "This filing requirement is designed to give the Commission the opportunity to prevent new rates from going into effect if it has reason to believe the new rates are not just and reasonable." *Id.* at 593-94. Once filed, however, and found just and reasonable as the statute requires, the rates are not subject to judicial challenge.[11]

The Natural Gas Act provides that all rates and charges of a pipeline must be "just and reasonable". 15 U.S.C. 717c(a). As this Court found in one of its early cases interpreting the Natural Gas Act, "[t]he fixing of 'just and reasonable' rates with the power attendant thereto [is] the heart of the new regulatory system." *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 600-601 and 611 (1944). When reviewing cases under this statute, this Court has consistently affirmed the right of the Commission, over that of the courts, to apply the "just and reasonable" standard to the spe-

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[11] As an adjunct to the filed rate doctrine, this Court explained in *Hall* that once the Commission, under section 4 of the Natural Gas Act, found that a rate is unjust or unreasonable, it is empowered under section 5(a) of the Natural Gas Act to "determine the just and reasonable rate . . . to be *thereafter* observed and enforced." 453 U.S. at 578 (emphasis in original). Limiting the Commission's rate determination to the future is commonly referred to as the prohibition against retroactive ratemaking. In other words, as this Court explained, the Natural Gas Act "bars 'the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate.'" *Id., quoting City of Piqua v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979).

cific factual dispute presented. "The power to fix rates for natural gas transported and sold in interstate commerce has been *entrusted solely* to the [Commission]." *Public Utilities Comm'n of Ohio v. United Fuel Gas Co.*, 317 U.S. 456, 468 (1943) (emphasis added). "Congress has entrusted the administration of the Act to the Commission, not to the courts. Apart from the requirements of judicial review it is not for us to advise the Commission how to discharge its functions." *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 617 (1944). "[I]t is not the function of a court itself to engage in ratemaking." *Federal Power Comm'n v. Colorado Interstate Gas Co.*, 348 U.S. 492, 501 (1955). Contrary to the decision of the Court of Appeals here, this Court has uniformly recognized that "Congress has entrusted the regulation of the natural gas industry to the informed judgment of the Commission, and not the preferences of reviewing courts." *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968).

"The primary aim of [the Natural Gas Act] was to protect consumers against exploitation at the hands of natural gas companies", 320 U.S. at 610, while at the same time maintaining the "financial integrity" of those companies. *Id.* at 603. *See also Federal Power Comm'n v. Memphis Light Gas & Water Div.*, 411 U.S. 458, 474 (1973) ("[R]ates are 'just and reasonable' only if consumer interests are protected and if the financial health of the pipeline in our economic system remains strong."). Congress entrusted to the Commission the balancing of these two competing concerns, as the Commission did here, when establishing "just and reasonable" rates. *Id.*

This Court's succinct explanation of the applicable standard of review follows:

> [T]he Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of "pragmatic adjustments."

> And when the Commission's order is challenged in the courts, the question is whether that order "viewed in its entirety" meets the requirements of the Act. Under the statutory standard of "just and reasonable" it is the result reached not the method employed which is controlling. It is not theory but the impact of the rate order which counts. *If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.*

Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. at 602 (citations omitted) (italics added). The Court of Appeals did not comply with this standard of review but erroneously focused only on the methodology employed, rather than whether the result reached by the Commission was indeed just and reasonable as the Commission found.

This Court has consistently granted writs of certiorari on appeals of Commission decisions that addressed a nationwide crisis in the natural gas industry. *See, e.g., In re Permian Basin Area Rate Cases*, 390 U.S. 747, 755 (1968) (As to the crisis in regulating producers, this Court found that "[b]ecause these proceedings begin a new era in the regulation of natural gas producers, we granted certiorari."). Recently, the Court granted a writ of certiorari to the United States Court of Appeals for the Fifth Circuit on its reversal of the Commission's Order No. 451, which, like Order No. 500 at issue here, is a critical part of the major restructuring underway in the natural gas industry. *Mobil Oil Co. v. FERC*, 885 F.2d 209 (5th Cir. 1989), *cert. granted*, No. 89-1452 (June 4, 1990).

In this case, the very integrity of the Natural Gas Act, and its cornerstone provision of "just and reasonable" rates, is threatened. A writ is especially appropriate when, as here, the statutory interpretation by the

Court of Appeals "seriously frustrates the proper administration of the Natural Gas Act." *United Gas Pipe Line Co. v. Memphis Light Gas and Water Div.*, 358 U.S. 103, 109 (1958). As three Circuit Judges accurately noted in their dissent to the denial of rehearing *en banc*, "[t]he panel's overly rigid interpretation of the filed rate doctrine to invalidate that [Commission] Order *leaves the FERC essentially powerless to take care of the take-or-pay crisis.*" 898 F.2d at 811 (emphasis added) (J.A. at 34a). Therefore, this Court should grant the writ of certiorari.

II. The Decision Of The Court Of Appeals Unnecessarily Infringes On The Commission's Jurisdiction To Harmonize The Provisions Of The Natural Gas Act And Is Inconsistent With A Decision Of The Court Of Appeals For The Eighth Circuit

This Court, consistent with the mandate of Congress, recognizes the Commission as the primary interpreter and administrator of the Natural Gas Act. *See, e.g., In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968). In the past, this Court has vigilantly protected the jurisdiction of an administrative agency to reconcile divergent policies inherent in its statute. As this Court explained:

> We have long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations
>
> > "has been consistently followed by this Court whenever decision as to the meaning or reach of a statute has involved reconciling conflicting policies, and a full understanding of the force of the statutory policy in the given situation has depended upon more than ordinary knowledge respecting the matters subjected to agency regulations. [citations omitted]

> ". . . If [the agency's] choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned." [citations omitted]
>
> In light of these well-settled principles it is clear that the Court of Appeals misconceived the nature of its role in reviewing the regulations at issue.

Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844-45 (1984). "If the agency regulation is not in conflict with the plain language of the statute, a reviewing court *must* give deference to the agency interpretation." *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 292 (1988) (emphasis added).

"[T]his Court's consistent and clearly articulated approach to the question of the Commission's power to regulate rates . . . [is] that no single method need be followed by the Commission in considering the justness and reasonableness of rates." *Wisconsin v. Federal Power Comm'n*, 373 U.S. 294, 309 (1963) (citations omitted). Rather, the Commission "must be free, within the limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation *capable of equitably reconciling diverse and conflicting interests.*" *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968) (emphasis added). In fashioning a remedy, the Commission must naturally consider "the practical consequences [resulting] . . . and the purposes of the Act." *Sunray Mid-Continent Oil Co. v. Federal Power Comm'n*, 364 U.S. 137, 147 (1960). "The breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties." 390 U.S. at 790.

"Allocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science." *Colorado Interstate Gas Co. v. Federal Power Comm'n,* 324 U.S. 581, 589 (1945). The refusal of the Court of Appeals to address the Commission's equitable findings, and to harmonize the filed-rate doctrine with the just and reasonable rate standard, is not proper and conflicts with the decisions of this Court.

Moreover, the decision of the Court of Appeals conflicts with a recent decision of the Eighth Circuit. In *Maislin Industries v. Primary Steel Inc.,* 897 F.2d 400 (8th Cir. 1989), *cert. granted,* 110 S.Ct. 34 (1990), the Court of Appeals held that a federal administrative agency, the Interstate Commerce Commission, properly declined to apply the filed rate doctrine when ensuring that the result reached was just and reasonable. According to the Eighth Circuit, fundamental ratemaking principles that are at the very core of the statute override a strict application of the filed rate doctrine. As the Court of Appeals explained, with equal application here, the filed rate doctrine "is only part of an overall regulatory scheme administered" by the Commission and "there is no provision in the [Act] elevating [it] over [the] section which requires that tariff rates be reasonable." *Id.* at 405. Rather, when conflicts arise, "the proper authority to harmonize these competing provisions is the [Commission]." *Id.* This approach "does not abolish the filed rate doctrine, but merely allows the [Commission] to consider all of the circumstances, including equitable defenses," to determine if the rates charged are just and reasonable. *Id.* This is exactly what Petitioners seek here.

III. The Court Of Appeals, Before Which Similar Cases Involving Other Pipelines Are Pending, Is Diametrically Split On The Proper Construction Of The Natural Gas Act

The Court of Appeals is divided on the interpretation of the "just and reasonable" rate provision of the Natural Gas Act, an important federal statute that plays a dominant role in the rates charged for the heating of homes in this country and the use of natural gas by the industries of this Nation. This fact alone weighs heavily in favor of this Court granting certiorari. The Court of Appeals did not address whether the rates charged were just and reasonable, *which is what the statute requires*, but rather preempted the statutory directive by focusing solely on the filed rate doctrine. Conversely, indicating the wide split within the same circuit, three other judges did not view the filed rate doctrine as a rule that overrides the "just and reasonable" rate standard.

Currently, the Court of Appeals is holding in abeyance fifty other cases involving the purchase deficiency allocation methodology.[12] Absent reversal by this Court, the remanding of these cases to the Commission will trigger massive administrative proceedings and time-consuming litigation and appeals to the courts. It is appropriate, therefore, for this Court to resolve the proper interpretation of the "just and reasonable" rate provision of the Natural Gas Act, characterized by this Court as "the heart of the new regulatory system." *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. at 611.

IV. The Court Of Appeals Erred In Relieving Those Customers Responsible For The Pipeline's Take-Or-Pay Costs From Bearing Their Fair Share Of Those Costs

Aside from the fundamental importance of the questions presented, an additional reason to grant the peti-

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[12] *See* Orders dated November 23, 1988 in D.C. Cir. Nos. 87-1588, *et al.*, 88-1046, *et al.*, and 88-1385, *et al.*

tion is the extreme adverse impact the decision below will have on the stability of small systems serving the rural and economically depressed regions of this Nation.

The Tennessee Small General Service Customer Group ("SGS Group") consists of 23 customers located in the States of Mississippi, Louisiana, Tennessee, Kentucky and Ohio.[13] The Group comprises both small municipalities and investor-owned gas distribution systems.

The Cities of Clarksville, Springfield, and Portland, Tennessee also purchase gas under the GS Rate Schedule. The Humphreys County Utility District and Western Kentucky purchase gas under Tennessee's General Service, or G, Rate Schedule. Western Kentucky also purchases gas at some delivery points under the GS Rate Schedule. The loads which these distribution systems serve with gas from Tennessee are primarily residential and small commercial with very few industrial customers.

All of the members of the Small Customer Group operate gas distribution systems connected to Tennessee's system and are "full requirements" customers, dependent solely upon Tennessee for all of their sales or transportation gas. In the past, when Tennessee entered into the contracts that are the source of its take-or-pay

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[13] The SGS Group members purchase gas under Tennessee's Small General Service, or GS, Rate Schedule. Members of the Tennessee SGS Group are as follows: Adamsville Municipal Gas System, Tennessee; Baldwyn Mississippi Municipal Gas System, Mississippi; Boliver Municipal Gas System, Tennessee; Booneville Mississippi Municipal Gas, Mississippi; City of Morehead, Kentucky; City of Parsons, Tennessee; City of Waynesboro, Tennessee; Collinwood Municipal Gas System, Tennessee; Delta Natural Gas Company, Kentucky; Dickson Tennessee Municipal Gas, Tennessee; Entex, Mississippi; Hardeman-Fayette Utility District, Moscow, Tennessee; Henderson Gas Department, Tennessee; Lexington Gas System, Tennessee; Linden Natural Gas, Tennessee; Louisiana Gas Service Company, Louisiana; Pike Natural Gas Company, Ohio; Sam Houston Utility District, Tennessee; Savannah Municipal Gas System, Tennessee; and Senatobia Public Works Department, Mississippi.

problem, and during the period that Tennessee accrued its major take-or-pay obligations, these customers were required to and did indeed purchase all of their gas supplies from Tennessee. Although Tennessee now has an open-access transportation policy giving G and GS customers the opportunity to transport gas purchased from others, Rate Schedules G and GS customers, in order to remain eligible under their rate schedules, must either purchase gas from Tennessee, or have third-party purchased gas transported and delivered by Tennessee. Rate Schedule G and GS customers thus must rely entirely on the Tennessee system for delivery of their full gas requirements.

As demonstrated at the hearing before the judge, the small, full requirements customers simply did *not* contribute to Tennessee's take-or-pay costs because they continued to buy gas from Tennessee at or above their historical purchase levels. Specifically, the Commission's presiding judge stated that the "*Tennessee Small General Service Customers Group (SGS Group) argue*[d] *persuasively that since they did not cause any of the take-or-pay costs, none of these costs should be extracted from them.*" [14] Rather, the judge found that "it is apparent that a decline in a customer's purchases from Tennessee translates directly to a decline in Tennessee's ability to meet its purchase obligations." [15] Therefore, the purchase deficiency methodology of Order No. 500, whereunder small full requirements customers are responsible for, at most, a minor portion of such costs, achieves a just and reasonable resolution of this proceeding.

An analysis of the *actual* historical gas purchases of the Rate Schedule G and GS customers demonstrates that, as a class, they did not in fact cause Tennessee's take-

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[14] *Tennessee Gas Pipeline Co.*, 36 FERC ¶ 61,032 at 65,008 (1987) (J.A. at 89a).

[15] *Id.* (J.A. at 76a).

or-pay problems. As a class, both the Rate Schedule G and GS customers' purchases of gas *increased* during the critical 1981-1985 deficiency period.[16] Tennessee testified that the pipeline's marketing department estimated customer demand when considering the acquisition of additional gas supplies.[17] In developing this estimate, Tennessee contacted and relied upon its 35 to 40 largest customers, which accounted for 85 to 90 percent of Tennessee's system sales.[18] However, Tennessee did not undertake a similar approach with the smaller customers purchasing under the G and GS Rate Schedules. Instead, Tennessee internally estimated these customers' requirements based on historical takes and applied a 1 or 2 percent escalator.[19] In estimating gas supply, Tennessee did not review the needs of each of the G and GS customers, but grouped the small customers together as one service unit. Once that figure was calculated, it represented those customers' portion of Tennessee's supply requirements.[20]

Moreover, during the period when Tennessee was experiencing deficiencies in customer purchases, the G and GS customers *exceeded* Tennessee's estimates of their col-

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[16] See, REM-1 at 21; and REM-3.

[17] Transcript ("Tr.") at 1174. All transcript citations are contained in the pages of the Certified Record before the Court of Appeals.

[18] Ex. JRK-1 at 5.

[19] Tr. 1175. Tennessee's witness testified that:

> [Tennessee] merely looked at the historical takes of the small customers . . . and projected future takes based on a small escalator for growth in their territories. Most of the loads that [Tennessee] served of those small customers were the high priority residential, commercial loads and as such were pretty . . . easy to be able to project.

[20] Tr. 1176; *see also* Tr. 1181-82 (when Tennessee decided to purchase gas, the G and GS component was based upon the pipeline's own imputed demand forecasts).

lective purchases. For example, average purchases by the GS customers were *15 percent higher* in the 1983-1985 deficiency period than they were in 1981-1982 base period.[21] In fact, in 1985 alone, the purchases by the GS customers were *13.6 percent above* their purchases in 1981.[22] In addition, purchases by Rate Schedule G customers were *3.2 percent higher* in the 1983-1985 deficiency period than they were in the 1981-1982 base period.[23] Importantly, the total purchases by G and GS customers were *6.4 percent higher* in 1983-1985 than they were in 1981-1982 [24] and 5.1 percent higher in 1985 than in 1981.[25]

The decision of the Court of Appeals may result in substantial take-or-pay costs being allocated to Rate Schedule G and GS customers that did not contribute to Tennessee's take-or-pay costs and that, in fact, purchased more gas than Tennessee itself estimated they would when calculating its supply requirements. Such a result would be inconsistent with the substantial evidence contained in the record before the agency, would disregard the time-honored rate-making principle relied upon by the Commission in adopting the purchase deficiency allocation methodology, and would result in unjust and unreasonable rates that are unlawful under the Natural Gas Act.

The Commission adopted the "cumulative deficiency" allocation methodology to ensure that the customers that caused the incurrence of take-or-pay—through a precipitous decline in purchases—would pay a fair share of the pipeline's current costs associated therewith. The deci-

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[21] *See* REM-1 at 21.

[22] *Id.*

[23] *See* REM-5 at 1.

[24] *Id.* at 2.

[25] *Id.* at 3.

sion of the Court of Appeals will, in all likelihood, relieve those customers that created Tennessee's take-or-pay costs from paying their fair share of the costs of solving the problem, while shifting much of their proper share to customers that were not responsible for causing them. This is clearly inequitable and will result in unjust and unreasonable rates.

The record in this proceeding demonstrates that *four* of Tennessee's interstate pipeline customers, specifically Columbia Gas Transmission Corporation, Consolidated Gas Transmission Corporation, Midwestern Gas Transmission Company and National Fuel Gas Supply Corporation, dramatically reduced their purchases from Tennessee during the critical 1981-1985 period. These pipelines clearly should be responsible for the lion's share of Tennessee's costs of solving the problem.

These customers permanently reduced their contract purchases as follows: [26]

	Reduction From 1981-82 to 1984-85	Reduction From 1981 to 1985
Columbia Gas Transmission Corporation	50.4%	73.0%
Consolidated Gas Transmission Corporation	29.1%	56.4%
Midwestern Gas Transmission Company	20.8%	51.9%
National Fuel Gas Supply Corporation	20.2%	33.1%

Under the "cumulative deficiency" methodology adopted by the Commission, these four customers would otherwise

[26] REM-5 (p. 4).

be responsible for 80.7% of Tennessee's costs, or $524.6 million. On the other hand, if Tennessee's costs are allocated through a mechanism based on *current* purchase levels, the pipeline customers would substantially avoid such costs because they are no longer purchasing significant volumes of gas from Tennessee. Similarly, any allocation mechanism which seeks to allocate costs on the basis of a customer's firm contract demand entitlement would likewise produce unjust and unreasonable rates. Thus, under the decision of the Court of Appeals, a large portion of those costs will be avoided by these four pipelines and, instead, may be shifted to others, including the small customers, that continued to purchase gas from Tennessee.

CONCLUSION

Precedent of this Court places solely with the Commission the responsibility of determining whether the rates proposed by a natural gas pipeline are just and reasonable. Departing abruptly and erroneously from this precedent, the Court of Appeals has now substituted its judgment for that of the Commission as to the "just and reasonable" rates on the Tennessee system. To do so, the Court of Appeals violated this Court's holding in *Hall* by relying mistakenly on the judicially-created filed rate doctrine as a substitute for the Natural Gas Act's just and reasonable rate standard. Having satisfied the doctrine as announced in *Hall*, the Commission fulfilled its duties as mandated by the Natural Gas Act. The Court of Appeals clearly erred in reversing the agency's determination.

For the reasons set forth herein, Petitioners pray that a writ of certiorari issue to the United States Court of Appeals for the District of Columbia Circuit, and upon review of the record in that court, its judgment be re-

versed and the decision of the Federal Energy Regulatory Commission be upheld.

Respectfully submitted,

MICHAEL J. MANNING
Counsel of Record
JAMES F. MORIARTY
FULBRIGHT & JAWORSKI
1150 Connecticut Ave., N.W.
Suite 400
Washington, D.C. 20036
(202) 452-6800
Attorneys for
Tennessee Small General Service Customer Group

JAMES R. CHOUKAS-BRADLEY
DEMETRIOS G. PULAS, JR.
MILLER, BALIS & O'NEIL, P.C.
1101 14th Street, N.W.
Suite 1400
Washington, D.C. 20005
Attorneys for
Cities of Clarksville, Springfield, and Portland, Tennessee, and Humphreys County Utility District, Tennessee

DAVID B. WARD
FLOOD & WARD
1000 Potomac Street, N.W.
Suite 402
Washington, D.C. 20007
Attorneys for
Western Kentucky Gas Company, A Division of Atmos Energy Corp.

ADDENDUM

ADDENDUM

PETITIONERS' RULE 29.1 STATEMENT

The members of the Tennessee SGS Group are as follows:

Adamsville Municipal Gas System, Tennessee
Baldwyn Mississippi Municipal Gas System
Bolivar Municipal Gas System, Tennessee
Bonneville Mississippi Municipal Gas
City of Batesville, Mississippi
City of Corinth, Mississippi
City of Holly Springs, Mississippi
City of Morehead, Kentucky
City of Parsons, Tennessee
City of Waynesboro, Tennessee
Como Utility Department, Mississippi
Delta Natural Gas Company, Lexington, Kentucky
Greater Dickson Gas Authority
Entex, a division of ARKLA, Inc., Texas
Hardeman-Fayette Utility District,
Moscow, Tennessee
Henderson Gas Department, Tennessee
Lexington Gas System, Tennessee
Linden Natural Gas, Tennessee
Louisiana Gas Service Company, Harvey, Louisiana
Pike Natural Gas Company, Hillsboro, Ohio
Savannah Municipal Gas System, Tennessee
Senatobia Public Works Department, Mississippi

Of these members, only Entex and Louisiana Gas Service Company have parent companies and/or wholly-owned subsidiaries.

Entex is a division of Arkla, Inc. Other divisions include Arkla Energy Resources, Arkansas Louisiana Gas Company, Arkla Pipeline Group and Mississippi River Transmission Corporation. The subsidiaries of Arkla, Inc., are as follows:

Arkla Chemical Corporation
Arkansas Louisiana Finance Corporation

Arkla Industries Inc.
Arkla Energy Marketing Company
AER-Arkansas Gas Transit Company
ALG Gas Supply Company
Arkla Intrastate Pipeline Company
Mississippi River Transmission Corporation
National Furnace Company
Arkla Products Company
Allied Materials Corporation
Datokek, Inc.
Entex Coal Company
Entex Gas Marketing Company
Entex Oil Company
Entex Oil & Gas Co.
Industrial Gas Supply Corporation
Louisiana Unit Gas Transmission Company
Unit Gas Transmission Company
United Gas, Inc.
Arkla Exploration Company

Louisiana Gas Service Company is a subsidiary of Louisiana General Services, Inc. Other subsidiaries include:

- LGS Pipeline, Inc.
  - LGS Natural
  - LGS Intrastate, Inc.
- LGS Exploration, Inc.
- LGS Energy Corporation
- LaGenerale Surety Co., Ltd.
- LGS Concord Corporation
- LGS Financial Services, Inc.
- LGS Securities, Inc.

The Cities of Clarksville, Portland and Springfield, Tennessee and the Humphreys County Utility District, Tennessee do not have parent companies or wholly-owned subsidiaries.

The remaining Petitioner, Western Kentucky Gas Company, is a Division of Atmos Energy Corp.